
FINANCIAL SECTION



KPMG LLP
Suite 1800
420 20th Street North
Birmingham, AL 35203

Independent Auditors' Report

Boards of Control
Teachers' Retirement System of Alabama
Employees' Retirement System of Alabama
Judicial Retirement Fund:

We have audited the accompanying combining statement of plan net assets of the Retirement Systems of Alabama (consisting of the Teachers' Retirement System of Alabama, the Employees' Retirement System of Alabama, and the Judicial Retirement Fund), component units of the State of Alabama, as of September 30, 2006, and the related combining statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the management of the Retirement Systems of Alabama. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Retirement Systems of Alabama's 2005 financial statements and, in our report dated March 8, 2006, we expressed an unqualified opinion on such financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Retirement Systems of Alabama's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Retirement Systems of Alabama (component units of the State of Alabama) as of September 30, 2006, and the results of their operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 14 through 17 and the schedules of funding progress and employer contributions (pages 39 and 40) are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 42 through 44 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

March 5, 2007

Management's Discussion and Analysis

The Retirement Systems of Alabama (RSA) is comprised of the Teachers' Retirement System (TRS), Employees' Retirement System (ERS), and Judicial Retirement Fund (JRF). The following discussion provides an overview of the financial position and results of operation for the RSA as of and for the period ended September 30, 2006, respectively. For more detailed information, please refer to the financial statements, including the Notes to the Financial Statements and the Required Supplementary Information.

Financial Statements and Required Supplementary Information

The financial statements (statements) include the Combining Statement of Plan Net Assets and the Combining Statement of Changes in Plan Net Assets. The Notes to the Financial Statements are considered an integral part of the financial statements. The statements are prepared using the economic resources measurement focus and accrual basis of accounting. Revenues are recognized when earned, pursuant to plan requirements, and expenses are recognized when incurred, regardless of when cash is received or expended. Investments are reported at fair value.

Combining Statement of Plan Net Assets – Includes all accounting assets and liabilities of the RSA and provides a snapshot of the financial position of the RSA as of the end of the fiscal year. Assets less liabilities results in the net assets held in trust for pension benefits at fiscal year-end.

Combining Statement of Changes in Plan Net Assets – Reports all additions and deductions of the RSA for the fiscal year. Additions primarily consist of employer contributions, employee contributions, and investment income. Deductions are principally made up of retirement allowance payments. Additions minus deductions provide the change in plan net assets for the fiscal year. The change in plan net assets plus the beginning plan net assets results in the plan net assets at fiscal year-end.

The Notes to the Financial Statements include plan descriptions, a summary of significant accounting policies, a description of legally required reserves and corresponding reserve balances at year-end, credit risk disclosures for cash and investments, concentration of investments disclosures, and securities lending disclosures.

The Required Supplementary Information following the Notes to the Financial Statements includes a Schedule of Funding Progress and a Schedule of Employer Contributions. The Schedule of Funding Progress provides trend data on the level of funding for the TRS, ERS, and JRF plans. The Schedule of Employer Contributions provides trend data on the annual required employer contributions and the percentage actually contributed. The Notes to the Required Supplementary Information provide disclosures concerning actuarial assumptions.

Comparative Summary Statements

Summary Comparative Statement of Plan Net Assets As of September 30, 2006 and 2005 (Amounts in Thousands)

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
<i>Assets</i>				
Cash	\$ 15,804	\$ 17,114	\$ (1,310)	(7.65)
Receivables	329,823	277,289	52,534	18.95
Investments	28,091,981	26,573,524	1,518,457	5.71
Invested Securities Lending Collateral	2,811,823	2,124,251	687,572	32.37
Property and Equipment	<u>24,500</u>	<u>5,102</u>	<u>19,398</u>	380.20
Total Assets	<u>31,273,931</u>	<u>28,997,280</u>	<u>2,276,651</u>	7.85
<i>Liabilities</i>				
Accounts Payable and Other Liabilities	6,016	6,579	(563)	(8.56)
Securities Lending Collateral	<u>2,811,823</u>	<u>2,124,251</u>	<u>687,572</u>	32.37
Total Liabilities	<u>2,817,839</u>	<u>2,130,830</u>	<u>687,009</u>	32.24
<i>Net Assets</i>	<u><u>\$ 28,456,092</u></u>	<u><u>\$ 26,866,450</u></u>	<u><u>\$ 1,589,642</u></u>	5.92

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)

Summary Comparative Statement of Changes in Plan Net Assets For the Fiscal Years Ended September 30, 2006 and 2005

(Amounts in Thousands)

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
Additions				
Employee Contributions	\$ 464,702	\$ 420,627	\$ 44,075	10.48
Employer Contributions	684,861	552,651	132,210	23.92
Investment Income	2,306,814	2,706,758	(399,944)	(14.78)
Transfers Between Systems	6,376	4,940	1,436	29.07
Total Additions	<u>3,462,753</u>	<u>3,684,976</u>	<u>(222,223)</u>	(6.03)
Deductions				
Retirement Allowance Payments	1,777,821	1,598,272	179,549	11.23
Return of Contributions, Unit Withdrawals, and Death Benefits	68,508	67,361	1,147	1.70
Transfers Between Systems	6,376	4,940	1,436	29.07
Administrative Expense	19,607	17,651	1,956	11.08
Depreciation	799	762	37	4.86
Total Deductions	<u>1,873,111</u>	<u>1,688,986</u>	<u>184,125</u>	10.90
Increase in Plan Net Assets	<u>1,589,642</u>	<u>1,995,990</u>	<u>(406,348)</u>	(20.36)
Net Assets - Beginning of Year	<u>26,866,450</u>	<u>24,870,460</u>	<u>1,995,990</u>	8.03
Net Assets - End of Year	<u>\$ 28,456,092</u>	<u>\$ 26,866,450</u>	<u>\$ 1,589,642</u>	5.92

Comparison of Individual Plan Net Assets As of September 30, 2006 and 2005

(Amounts in Thousands)

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>% Increase/ (Decrease)</u>
TRS	\$ 19,207,803	\$ 18,168,523	\$ 1,039,280	5.72
ERS	9,001,867	8,464,515	537,352	6.35
JRF	<u>246,422</u>	<u>233,412</u>	<u>13,010</u>	5.57
Totals	<u>\$ 28,456,092</u>	<u>\$ 26,866,450</u>	<u>\$ 1,589,642</u>	5.92

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)

Financial Analysis

- Employee contributions receivable increased 19.4%, employer contributions receivable increased 34.8%, employee contributions increased 10.5% and employer contributions increased 23.9% primarily as a result of increased active membership and salary increases. Employer rate increases also contributed to the increase in employer contributions receivable and employer contributions.
- Dividends and interest receivable increased 15.2% due to higher interest rates and lower than normal dividends and interest receivable in the previous fiscal year due to restructuring and liquidation of debt that occurred toward the end of the previous fiscal year.
- Assets and liabilities related to securities lending increased as a result of greater securities lending activities.
- Investments increased mainly as a result of increases in the fair value of investments. Investment income decreased as a result of a lower overall market increase in the fair value of investments. The S&P 500 increased 10.79% in 2006 compared to a return of 12.25% in 2005 and the S&P Midcap 400 increased 6.56% in 2006 compared to 22.16% in 2005.
- Property and equipment increased 380.2% mainly due to the ongoing construction of a new administrative building.
- Retirement allowance payments increased by \$179.5 million primarily due to new retirees, adhoc cost of living adjustments for retirees and the first full year of members participating in the Deferred Retirement Option Plan (DROP) became eligible for disbursements from the DROP.

Funding Status

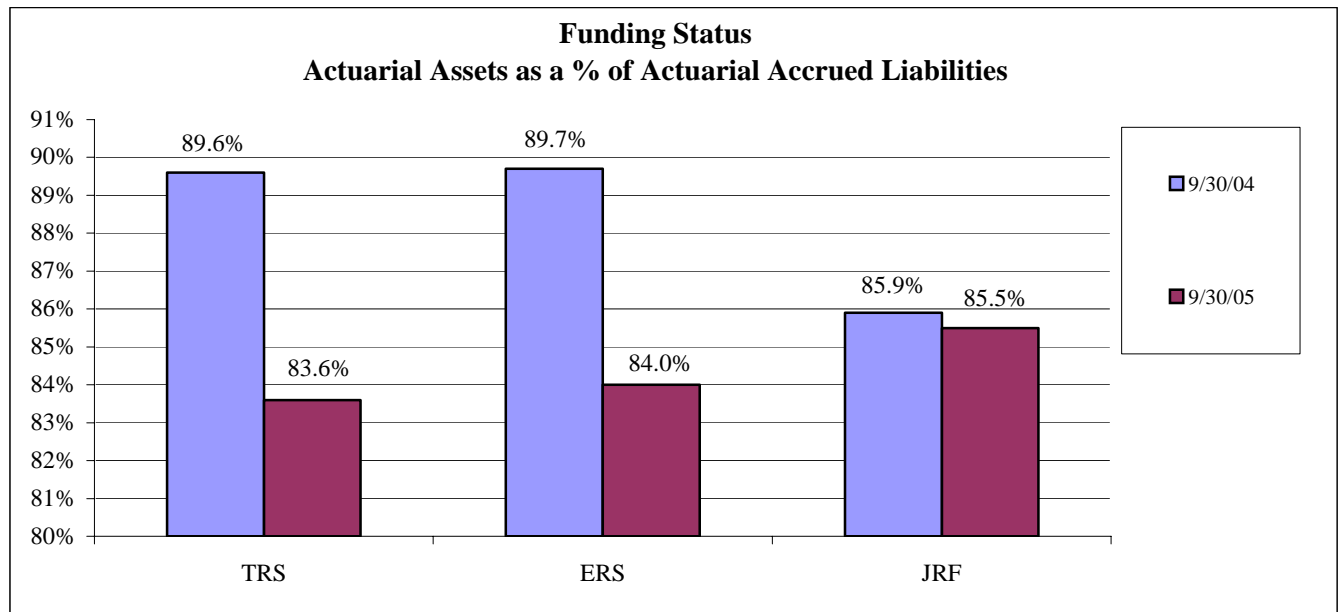
The primary objective of a retirement system is to accumulate sufficient assets to pay benefits to participants when due. The principal sources of assets to fund benefits include investment income and member and employer contributions. A five-year smoothing method is used in actuarially valuing assets to limit fluctuations in the contributions from year to year.

The ratio of actuarial assets to actuarial liabilities provides an excellent indication as to whether sufficient assets are being accumulated to pay benefits when due. The following bar graph provides comparisons of the funded ratio (actuarial assets to actuarial liabilities) as of the last two valuations for each System (September 30, 2005 and September 30, 2004). The funded ratio has decreased in the most recent valuations as a result of the continued amortization of losses in fair value of investments that occurred in fiscal years 2001 and 2002 and 7% in adhoc cost of living adjustments for retirees. Since a five-year smoothing method is employed to value assets, the funded ratio is likely to continue to decrease over the next few years as the recent losses are incorporated into the smoothing calculations. However, as reflected by the following graph, the TRS, ERS, and JRF continue to operate on an actuarially sound basis and accumulated funds are sufficient to continue to provide benefits as they become due.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Management's Discussion and Analysis (Continued)



Financial Highlights

- Total assets exceeded total liabilities at September 30, 2006, by \$28.5 billion. Net assets are held in trust to meet future benefit payments.
- The funding level (actuarial value of assets as a percent of actuarial accrued liabilities) as of the latest actuarial valuations was 83.6% for the TRS, 84.0% for the ERS, and 85.5% for the JRF.
- The fair value of investments increased by \$1.3 billion during the fiscal year.
- The investment section contains a detailed schedule of investment returns and related benchmarks.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Combining Statement of Plan Net Assets

September 30, 2006 with comparative figures for 2005

(Amounts in Thousands)

	2006			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Assets				
Cash (Note 4)	\$ 9,653	\$ 5,074	\$ 1,077	\$ 15,804
Receivables				
Employee Contributions	23,814	14,553	112	38,479
Employer Contributions	38,912	22,281	303	61,496
Dividends and Interest	154,800	73,728	1,320	229,848
Total Receivables	217,526	110,562	1,735	329,823
Investments, at Fair Value (Note 5)				
Domestic Equity Securities	9,157,003	4,345,437	153,064	13,655,504
Domestic Fixed Income Securities	4,990,746	2,314,148	68,108	7,373,002
International Securities	2,967,620	1,307,815	-	4,275,435
Real Estate	1,206,840	583,690	2,494	1,793,024
Short-term Investments	646,143	328,769	20,104	995,016
Total Investments	18,968,352	8,879,859	243,770	28,091,981
Invested Securities Lending Collateral (Note 5)	1,922,021	864,409	25,393	2,811,823
Property and Equipment less Accumulated Depreciation (Note 8)	15,875	8,625	-	24,500
Total Assets	21,133,427	9,868,529	271,975	31,273,931
Liabilities				
Accounts Payable and Other Liabilities	3,603	2,253	160	6,016
Securities Lending Collateral (Note 5)	1,922,021	864,409	25,393	2,811,823
Total Liabilities	1,925,624	866,662	25,553	2,817,839
Net Assets Held in Trust for Pension Benefits (Note 3)	\$ 19,207,803	\$ 9,001,867	\$ 246,422	\$ 28,456,092

A "Schedule of Funding Progress" is presented on page 39.

See accompanying Notes to the Financial Statements .

	2005			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Assets				
Cash	\$ 12,508	\$ 3,696	\$ 910	\$ 17,114
Receivables				
Employee Contributions	21,478	10,624	114	32,216
Employer Contributions	30,264	15,042	304	45,610
Dividends and Interest	134,163	64,084	1,216	199,463
Total Receivables	185,905	89,750	1,634	277,289
Investments, at Fair Value				
Domestic Equity Securities	8,329,184	3,861,335	140,393	12,330,912
Domestic Fixed Income Securities	5,030,232	2,327,077	71,211	7,428,520
International Securities	2,523,056	1,068,022	-	3,591,078
Real Estate	1,147,347	553,441	2,473	1,703,261
Short-term Investments	941,540	561,290	16,923	1,519,753
Total Investments	17,971,359	8,371,165	231,000	26,573,524
Invested Securities Lending Collateral	1,460,243	644,950	19,058	2,124,251
Property and Equipment less Accumulated Depreciation	2,873	2,229	-	5,102
Total Assets	19,632,888	9,111,790	252,602	28,997,280
Liabilities				
Accounts Payable and Other Liabilities	4,122	2,325	132	6,579
Securities Lending Collateral	1,460,243	644,950	19,058	2,124,251
Total Liabilities	1,464,365	647,275	19,190	2,130,830
Net Assets Held in Trust for Pension Benefits	\$ 18,168,523	\$ 8,464,515	\$ 233,412	\$ 26,866,450

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Combining Statement of Changes in Plan Net Assets

For the Fiscal Year Ended September 30, 2006 with comparative figures for 2005

(Amounts in Thousands)

	2006			
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Additions				
Contributions				
Employee	\$ 278,220	\$ 184,144	\$ 2,338	\$ 464,702
Employer	434,195	241,750	8,916	684,861
Transfers from Teachers' Retirement System	-	2,982	26	3,008
Transfers from Employees' Retirement System	3,235	-	133	3,368
Total Contributions	<u>715,650</u>	<u>428,876</u>	<u>11,413</u>	<u>1,155,939</u>
Investment Income (Note 5)				
<i>From Investing Activities</i>				
Net Increase in Fair Value of Investments	878,743	375,025	11,215	1,264,983
Interest and Dividends	<u>703,189</u>	<u>329,459</u>	<u>9,598</u>	<u>1,042,246</u>
Total Investment Income from Investing Activities	1,581,932	704,484	20,813	2,307,229
Less: Investment Expenses	<u>4,947</u>	<u>3,216</u>	<u>2</u>	<u>8,165</u>
Net Investment Income from Investing Activities	<u>1,576,985</u>	<u>701,268</u>	<u>20,811</u>	<u>2,299,064</u>
<i>From Securities Lending Activities</i>				
Securities Lending Income	84,052	35,407	908	120,367
Less Securities Lending Expenses:				
Borrower Rebates	77,407	32,567	861	110,835
Management Fees	<u>1,271</u>	<u>504</u>	<u>7</u>	<u>1,782</u>
Total Securities Lending Expenses	<u>78,678</u>	<u>33,071</u>	<u>868</u>	<u>112,617</u>
Net Income from Securities Lending Activities	<u>5,374</u>	<u>2,336</u>	<u>40</u>	<u>7,750</u>
Total Investment Income	<u>1,582,359</u>	<u>703,604</u>	<u>20,851</u>	<u>2,306,814</u>
Total Additions	<u>2,298,009</u>	<u>1,132,480</u>	<u>32,264</u>	<u>3,462,753</u>
Deductions				
Retirement Allowance Payments	1,207,251	551,793	18,777	1,777,821
Return of Contributions and Death Benefits	36,683	31,780	45	68,508
Transfers to Employees' Retirement System	2,982	-	-	2,982
Transfers to Teachers' Retirement System	-	3,235	-	3,235
Transfers to Judicial Retirement Fund	26	133	-	159
Administrative Expenses	11,325	7,850	432	19,607
Depreciation (Note 8)	<u>462</u>	<u>337</u>	<u>-</u>	<u>799</u>
Total Deductions	<u>1,258,729</u>	<u>595,128</u>	<u>19,254</u>	<u>1,873,111</u>
Net Increase	1,039,280	537,352	13,010	1,589,642
Net Assets Held in Trust for Pension Benefits:				
Beginning of Year	18,168,523	8,464,515	233,412	26,866,450
End of Year	<u>\$ 19,207,803</u>	<u>\$ 9,001,867</u>	<u>\$ 246,422</u>	<u>\$ 28,456,092</u>

See accompanying Notes to the Financial Statements .

2005				
	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Additions				
Contributions				
Employee	\$ 260,149	\$ 158,128	\$ 2,350	\$ 420,627
Employer	347,862	195,846	8,943	552,651
Transfers from Teachers' Retirement System	-	1,829	-	1,829
Transfers from Employees' Retirement System	2,707	-	48	2,755
Transfers from Judicial Retirement Fund	-	356	-	356
Total Contributions	<u>610,718</u>	<u>356,159</u>	<u>11,341</u>	<u>978,218</u>
Investment Income				
<i>From Investing Activities</i>				
Net Increase in Fair Value of Investments	1,221,059	545,826	11,877	1,778,762
Interest and Dividends	<u>624,397</u>	<u>295,631</u>	<u>7,420</u>	<u>927,448</u>
Total Investment Income from Investing Activities	1,845,456	841,457	19,297	2,706,210
Less: Investment Expenses	<u>4,278</u>	<u>2,652</u>	<u>2</u>	<u>6,932</u>
Net Investment Income from Investing Activities	<u>1,841,178</u>	<u>838,805</u>	<u>19,295</u>	<u>2,699,278</u>
<i>From Securities Lending Activities</i>				
Securities Lending Income	40,399	17,604	422	58,425
Less Securities Lending Expenses:				
Borrower Rebates	33,559	14,948	362	48,869
Management Fees	<u>1,620</u>	<u>448</u>	<u>8</u>	<u>2,076</u>
Total Securities Lending Expenses	<u>35,179</u>	<u>15,396</u>	<u>370</u>	<u>50,945</u>
Net Income from Securities Lending Activities	<u>5,220</u>	<u>2,208</u>	<u>52</u>	<u>7,480</u>
Total Investment Income	<u>1,846,398</u>	<u>841,013</u>	<u>19,347</u>	<u>2,706,758</u>
Total Additions	<u>2,457,116</u>	<u>1,197,172</u>	<u>30,688</u>	<u>3,684,976</u>
Deductions				
Retirement Allowance Payments	1,092,723	487,348	18,201	1,598,272
Return of Contributions and Death Benefits	36,350	30,960	51	67,361
Transfers to Employees' Retirement System	1,829	-	356	2,185
Transfers to Teachers' Retirement System	-	2,707	-	2,707
Transfers to Judicial Retirement Fund	-	48	-	48
Administrative Expenses	10,372	6,898	381	17,651
Depreciation	<u>468</u>	<u>294</u>	<u>-</u>	<u>762</u>
Total Deductions	<u>1,141,742</u>	<u>528,255</u>	<u>18,989</u>	<u>1,688,986</u>
Net Increase	1,315,374	668,917	11,699	1,995,990
Net Assets Held in Trust for Pension Benefits:				
Beginning of Year	<u>16,853,149</u>	<u>7,795,598</u>	<u>221,713</u>	<u>24,870,460</u>
End of Year	<u>\$ 18,168,523</u>	<u>\$ 8,464,515</u>	<u>\$ 233,412</u>	<u>\$ 26,866,450</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

1) PLAN DESCRIPTION

The Teachers' Retirement System (TRS), Employees' Retirement System (ERS), and Judicial Retirement Fund (JRF) operate under common management and are collectively referred to as the Retirement Systems of Alabama (RSA or Systems). In addition to executive management, the TRS, ERS, and JRF share investment management, accounting, and information system services, the costs of which are allocated to the funds on an equitable basis.

The TRS, a cost-sharing multiple-employer public employee retirement plan, was established as of September 15, 1939, under the provisions of Act 419 of the Legislature of 1939 for the purpose of providing retirement allowances and other specified benefits for qualified persons employed by State-supported educational institutions. The responsibility for the general administration and operation of the TRS is vested in its Board of Control.

The ERS, an agent multiple-employer public employee retirement plan, was established as of October 1, 1945, under the provisions of Act 515 of the Legislature of 1945. The purpose of the ERS is to provide retirement allowances and other specified benefits for State employees, State police, and on an

elective basis, to all cities, counties, towns, and quasi-public organizations. The responsibility for the general administration and operation of the ERS is vested in its Board of Control.

The JRF, a cost-sharing multiple-employer public employee retirement plan, was established as of September 18, 1973, under the provisions of Act Number 1163 of the Legislature of 1973 for the purpose of providing retirement allowances and other specified benefits for any Justice of the Supreme Court of Alabama, Judge of the Court of Civil Appeals, Judge of the Court of Criminal Appeals, Judge of the Circuit Court, or office holder of any newly created judicial office receiving compensation from the State Treasury. Act Number 1205 of the Legislature of 1975 supplemented the provisions of Act Number 1163 and enlarged the scope and coverage of the JRF to include District and Probate Judges. The responsibility for the general administration and operation of the JRF is vested in the Board of Control of the ERS.

At September 30, 2006, the number of participating units in each system was as follows:

	<u>TRS</u>	<u>ERS</u>
Cities	-	271
Counties	-	64
Other Public Entities	-	490
Universities	13	-
Post-Secondary Institutions	31	-
City and County Bds of Education	131	-
State Agencies & Other	<u>31</u>	<u>-</u>
Totals	<u>206</u>	<u>825</u>

At the date of the latest actuarial valuation as presented in the Notes to the Required Supplementary Information, membership consisted of:

	<u>TRS</u>	<u>ERS</u>	<u>JRF</u>
Retirees and beneficiaries currently receiving benefits:			
General	59,523	16,653	274
State Police	-	724	-
Employees of Local Employers	-	14,136	-
Deferred Retirement Option Plan (DROP)	4,839	1,753	-
Terminated employees entitled to benefits but not yet receiving benefits:			
General	14,520	3,294	49
State Police	-	7	-
Employees of Local Employers	-	6,658	-
Active employees:			
General	135,126	31,647	340
State Police	-	712	-
Employees of Local Employers	-	50,471	-
Totals	<u>214,008</u>	<u>126,055</u>	<u>663</u>

State law establishes retirement benefits as well as death and disability benefits and any ad hoc increase in postretirement benefits for the TRS, ERS, and JRF. Benefits for TRS and ERS members vest after 10 years of credited service. Teachers and state employees who retire after age 60 (52 for state police) with 10 years or more of credited service or with 25 years of service (regardless of age) are entitled to an annual retirement benefit, payable monthly for life. Local employees who retire after age 60 with 10 years or more of credited service or with 25 or 30 years of service (regardless of age), depending on the particular entity's election, are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or a formula method, with the member receiving payment under the method that yields the highest monthly benefit. Under the formula method, members of the TRS and ERS (except State Police) are allowed 2.0125% of their average final compensation (highest 3 of the last 10 years) for each year of service. State Police are allowed 2.875% for each year of state police service in computing the formula method.

The JRF benefits vest from five to eighteen years. Except for justices or judges who were either disabled, elected prior to July 30, 1979, or have at least 25 years of credited service, no justice or judge is eligible to receive judicial service retirement pay prior to attaining sixty years of age. Service retirement benefits for justices and judges are dependent upon the particular office held in the judicial branch of government. A retirement benefit is payable upon the request of any member who has: (1) 25 years of credited service (regardless of age), (2) completed 12 years of credited service and has attained age 65, (3) completed 15 years of credited service and whose age plus service equals or exceeds 77, (4) completed at least 18 years of credited service or three full terms as a judge or justice and has attained age 65, (5) completed 10 years of credited service and has attained age 70 or (6) been elected prior to July 30, 1979 and has 18 years of service (regardless of age). A member eligible to retire who has not requested his or her retirement benefit to commence at the end of the term in which the member's seventieth birthday occurs is entitled only to the refund of his or her contributions (except for members with at least 25 years of credited service).

(Dollar Amounts in Thousands)

The service retirement benefit for circuit, appellate, and probate judges is 75% of the member's salary at the time of separation from service. The service retirement benefit for a district judge is 75% of the position's salary immediately prior to retirement.

Covered members of the TRS and ERS (except state police and certified law enforcement, correctional officers and firemen) are required by statute to contribute 5% of earnable compensation to the TRS and ERS. State police members of the ERS contribute 10% of earnable compensation. JRF members and certified law enforcement, correctional officers, and firemen members of the TRS and ERS are required to contribute 6% of earnable compensation.

2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The TRS, ERS, and JRF financial statements are prepared using the accrual basis of accounting. Contributions are recognized as revenues when earned, pursuant to plan requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans. Expenses are recognized when the corresponding liability is incurred, regardless of when the payment is made. The accompanying financial statements are prepared in accordance with requirements of the Governmental Accounting Standards Board (GASB). Under these requirements, the TRS, ERS, and JRF are considered component units of the State of Alabama and are included in the State's Comprehensive Annual Financial Report.

B. Investments

The Boards of Control of the Systems have the responsibility and authority to invest and reinvest available funds, through the Secretary-Treasurer and Investment Committee, in bonds, mortgage-backed securities, common and preferred stock, and other investment vehicles with the care, skill, prudence, and diligence under the circumstances then

prevailing that a prudent person acting in a like capacity and familiar with such matters would use. All plan assets are carried at fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. Short-term investments are reported at cost, which approximates fair value. Mortgage-backed securities are reported based on future principal and interest payments discounted at the prevailing interest rate for similar instruments. The fair value of real estate investments is based on independent appraisals. Generally, private placements are valued based on the selling price of similar investments sold in the open market. In those instances where there are no similar investments sold in the open market, an appraisal is performed to determine the fair value of the private placements.

C. Comparative Combining Statements

The basic financial statements include the prior year Combining Statement of Plan Net Assets and Combining Statement of Changes in Plan Net Assets (Statements) for comparative purposes only. Prior-year Note Disclosures are not included. Therefore, the prior year basic financial statement presentation does not meet the minimum level of detail required for a presentation in conformity with generally accepted accounting principles. Accordingly, the prior year Statements should be read in conjunction with the RSA's prior year financial report from which the prior year Statements were derived.

3) LEGALLY REQUIRED RESERVES

A. Annuity Savings

Member contributions are credited to the Annuity Savings account. Interest at 4% per annum is credited to the annuity savings account of each member on the basis of the average of the beginning and end of year balances (as of June 30 for the TRS and September 30 for the ERS and JRF).

When a member withdraws from service prior to becoming vested, the member's accumulated contributions and a portion of accumulated interest credited to the Annuity Savings account are returned

to the member. The portion of accumulated interest that, by law, is not payable to the member is transferred to the Expense fund.

When a TRS or ERS member dies prior to becoming eligible for retirement, the member's accumulated contributions and accumulated interest credited to the Annuity Savings account are returned to the member's designated beneficiary. If the pre-retirement death benefit defined below is not payable, an additional death benefit equal to the member's accumulated contributions, up to five thousand dollars, is paid from the Pension Accumulation account to the member's beneficiary.

When a member retires or when a survivor allowance becomes payable, the amount of the member's accumulated contributions and accumulated interest is transferred from the Annuity Savings account to the Pension Accumulation account.

B. Pension Accumulation

The Pension Accumulation account is credited with contributions made by the employer and net investment income. The lump sum death benefit is paid from this account when a TRS or ERS member dies prior to becoming eligible for the pre-retirement death benefit or retirement. Periodic interest representing member's earnings is transferred from the Pension Accumulation account to the Annuity Savings account. When a TRS, ERS, or JRF member retires or when a survivor allowance becomes payable, the member's accumulated contributions and accumulated interest is credited to the pension accumulation account, and all monthly benefit payments are paid from this account.

C. Pre-retirement Death Benefit

The Pre-retirement Death Benefit (PRDB) account (established October 1, 1983, under the provisions of Act 616 of the Legislature of 1983) is credited with contributions made by TRS and ERS employers and investment income on such funds. The pre-retirement death benefit (in the form of group term life insurance) is paid in addition to the return of member contributions upon the death of an active

TRS or ERS member who has completed at least one year of active membership in the system and whose date of death was within 180 days of such member's last date of actual service. However, a surviving spouse beneficiary of a deceased member who was eligible for service retirement may elect a survivor allowance in lieu of this benefit. The pre-retirement death benefit is equal to the annual earnable compensation of the member as reported to the System for the preceding year ending June 30 for the TRS and September 30 for the ERS. There is no PRDB available for JRF members.

D. Term Life Insurance

The Alabama Teacher's Group Term Life Insurance Plan (established October 1, 1987) is credited with a portion of the employer contributions. All active contributing members of the TRS are covered by this plan. Contingent on availability of funds, upon death, a benefit is paid to the designated beneficiary of an insured member of the TRS. Beneficiaries of full-time employees receive fifteen thousand dollars while beneficiaries of part-time employees receive a pro-rated amount of fifteen thousand dollars.

E. Expense

The Expense fund is used to pay the administrative expenses of the RSA. A portion of the employer contributions and the interest not payable upon member withdrawal provide the funding of the Expense fund. The majority of expenses are directly identifiable as expenses of the TRS, ERS, or JRF. As discussed in Note 1, certain administrative salaries and other expenses are shared on an equitable basis between the TRS and ERS.

F. Deferred Retirement Option Plan (DROP)

The DROP was established for election to participate on or after June 1, 2002, under the provisions of Act 23 of the Legislature of 2002. Eligible members may elect to retire, and, in lieu of immediate withdrawal from service, continue employment for a period of three to five years. The retirement allowance, employee contributions, and interest earned are accumulated in an account for the benefit of the

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

member. At the end of participation, the account balance is paid to the member. DROP participation is an option available to eligible members that have at least twenty-five years of service (exclusive of sick leave), are at least fifty-five years of age, and are eligible for retirement. See the actuarial section for additional information.

G. Reserves

The reserves of the RSA are funded to the full extent required by statute. The reserve balances as of September 30, 2006, are as follows:

	<u>TRS</u>	<u>ERS</u>	<u>JRF</u>
Annuity Savings	\$ 2,943,588	\$ 1,719,569	\$ 31,569
Pension Accumulation	15,745,764	7,103,641	213,969
Preretirement Death Benefit	15,620	17,247	-
Term Life Insurance	10,511	-	-
Deferred Retirement Option Plan	468,413	148,994	-
Expense	8,032	3,791	884

4) CASH

Cash consists of deposits held by the State Treasurer in the respective retirement system's name. Deposits are entirely insured by Federal depository insurance or protected under the Security for Alabama Funds Enhancement (SAFE) Program. The *Code of Alabama 1975* requires all State organizations to participate in the SAFE Program. The SAFE Program is a multiple financial institution collateral pool. The SAFE Program requires all public funds to be deposited in a financial institution designated by the State Treasurer as a qualified public depository. Each qualified public depository is required to pledge collateral in accordance with the rules established by the SAFE Board of Directors. In the event that a qualified public depository defaults or becomes insolvent and the pledged collateral is insufficient to satisfy the claims of public depositors, the *Code of Alabama 1975, Section 41-14A-9(3)* authorizes the State Treasurer to make assessments against the other qualified public depositories in the pool so that there will be no loss of public funds. Virtually all cash on hand at September 30 was restricted for administrative purposes.

5) INVESTMENTS

A. Investment Risks

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, and foreign currency risk. The following describes those risks:

Interest Rate Risk – The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods. However, the System's intent is to hold all fixed maturity investments until maturity, and as such, fixed maturity investments are classified in the following tables as if they were held to maturity.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The RSA’s custodial credit risk policy requires the custodial agent to hold or direct its agents or subcustodians to hold, for the account of the RSA all securities and other non-cash property other than securities in the Federal Reserve book-entry system, in a clearing agency which acts as a securities depository, or in another book-entry system. The RSA’s safekeeping agent holds all investments of the RSA in the RSA’s name.

Credit Quality – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer’s ability to meet its obligations. Domestic fixed-maturity investments may consist of rated or non-rated securities. International fixed-maturity investments may consist of securities with a rating of at least A by one of the principal rating agencies at the time of purchase or acquisition, except that up to 2% of the fair value of each System’s total portfolio may be invested in obligations of sovereign countries with a rating of BBB or BAA at the time of purchase. The Systems may hedge against the possible adverse effects of currency fluctuations on each System’s portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A-2 and/or P-2, repurchase agreements, short-term U.S. securities, and other money market investments.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by the Systems,

the issuing company must be incorporated in a country whose debt securities are eligible for purchase as discussed above, and the fair value of the aggregate outstanding equity of the issuing company must be at least \$100 million.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments. The policy limits are as follows:

- Domestic Fixed Income – Limited to 70% of the fair value of the aggregate portfolio for each System.
- International Fixed Income – Limited to 10% of the fair value of each System’s total portfolio.
- Domestic Equity – Limited to 65% of the fair value of each System’s aggregate portfolio.
- International Equity – The aggregate fair value of international equities is limited to 15% of the aggregate fair value of each System’s total portfolio. Also, each System may not purchase or hold more than 5% of any class of the outstanding stock of a company.
- Real Estate – The suggested limit is 10% of the book value of each System’s portfolio.
- Alternative Investments (mezzanine financing, LBO’s, venture capital, limited partnerships, futures, commodities and derivative investments) – Limited to 5% of the book value of each System’s aggregate portfolio.
- Short-term Investments – Limited to 20% of the fair value of each System’s aggregate portfolio.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

The following tables provide information as of September 30, 2006, concerning the fair value of investments, interest rate risk, and foreign currency risk:

Type of Investment	INVESTMENTS				Total Fair Value	Cost
	TRS					
	Maturity in Years at Fair value					
	Less Than 1	1-5	6-10	More Than 10		
<i>Fixed Maturity</i>						
Domestic						
Commercial Paper	\$ 570,520	\$ -	\$ -	\$ -	\$ 570,520	\$ 570,520
U.S. Government Guaranteed	16,086	-	257,396	-	273,482	276,144
U.S. Agency	-	382,295	380,204	18,004	780,503	789,953
Corporate Bonds	19,524	520,670	405,702	567,463	1,513,359	1,477,361
Private Placements	14,175	168,610	312,309	1,855,601	2,350,695	2,954,024
GNMAs	58	2,015	1,347	39,418	42,838	40,045
CMOs	-	-	3,276	26,593	29,869	29,540
Money Market Funds	75,623	-	-	-	75,623	75,623
Total Domestic Fixed Maturity	695,986	1,073,590	1,360,234	2,507,079	5,636,889	6,213,210
International						
German - Euro	26,729	-	-	-	26,729	27,723
Total Intl Fixed Maturity	26,729	-	-	-	26,729	27,723
Total Fixed Maturity	\$ 722,715	\$ 1,073,590	\$ 1,360,234	\$ 2,507,079	5,663,618	6,240,933
<i>Equities</i>						
Domestic					9,157,003	6,764,039
International						
United Kingdom - Pound Sterling					705,330	526,391
Japan - Yen					692,360	559,572
France - Euro					297,855	198,261
Germany - Euro					208,231	154,410
Switzerland - Franc					207,320	125,953
Netherlands - Euro					105,085	78,021
Italy - Euro					114,275	85,938
Spain - Euro					122,839	76,547
Australia - U.S. Dollar					154,528	95,471
Singapore - U.S. Dollar					20,593	17,391
Belgium - Euro					36,305	23,740
Finland - Euro					42,318	35,176
Hong Kong - U.S. Dollar					48,344	37,889
Sweden - Krona					69,875	45,594
Denmark - Krone					21,710	13,958
Ireland - Euro					24,770	18,139
Norway - Krone					23,369	15,623
Other					45,784	35,386
Total International Equities					2,940,891	2,143,460
Total Equities					12,097,894	8,907,499
Real Estate					1,206,840	647,674
Total Investments					\$ 18,968,352	\$ 15,796,106

INVESTMENTS ERS						
Type of Investment	Maturity in Years at Fair Value				Total Fair Value	Cost
	Less Than 1	1-5	6-10	More Than 10		
<i>Fixed Maturity</i>						
Domestic						
Commercial Paper	\$ 277,716	\$ -	\$ -	\$ -	\$ 277,716	\$ 277,716
U.S. Government Guaranteed	8,662	-	119,681	-	128,343	129,514
U.S. Agency	-	140,629	169,097	8,653	318,379	321,940
Corporate Bonds	8,734	238,543	182,640	273,108	703,025	685,827
Private Placements	7,080	68,232	140,779	920,388	1,136,479	1,437,370
GNMAs	13	778	807	14,701	16,299	15,225
CMOs	-	-	1,357	10,266	11,623	11,540
Money Market Funds	51,053	-	-	-	51,053	51,054
Total Domestic Fixed Maturity	353,258	448,182	614,361	1,227,116	2,642,917	2,930,186
International						
Germany - Euro	14,343	-	-	-	14,343	14,876
Total Intl Fixed Maturity	14,343	-	-	-	14,343	14,876
Total Fixed Maturity	\$ 367,601	\$ 448,182	\$ 614,361	\$ 1,227,116	2,657,260	2,945,062
<i>Equities</i>						
Domestic					4,345,437	3,292,135
International						
United Kingdom - Pound Sterling					311,988	231,221
Japan - Yen					304,156	246,301
France - Euro					130,922	86,745
Germany - Euro					91,688	67,759
Switzerland - Franc					91,269	54,632
Netherlands - Euro					46,204	33,449
Italy - Euro					50,099	37,555
Spain - Euro					53,970	33,663
Australia - U.S. Dollar					67,469	41,599
Singapore - U.S. Dollar					9,116	7,712
Belgium - Euro					15,782	10,279
Finland - Euro					18,434	15,513
Hong Kong - U.S. Dollar					21,143	16,615
Sweden - Krona					30,502	20,017
Denmark - Krone					9,521	6,084
Ireland - Euro					10,878	7,910
Norway - Krone					10,249	6,958
Other					20,082	15,587
Total International Equities					1,293,472	939,599
Total Equities					5,638,909	4,231,734
Real Estate					583,690	320,859
Total Investments					\$ 8,879,859	\$ 7,497,655

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

INVESTMENTS						
JRF						
Type of Investment	Maturity in Years at Fair Value				Total Fair Value	Cost
	Less Than 1	1-5	6-10	More Than 10		
<i>Fixed Maturity</i>						
Domestic						
Commercial Paper	\$ 16,496	\$ -	\$ -	\$ -	\$ 16,496	\$ 16,496
U.S. Government Guaranteed	-	-	7,252	-	7,252	7,317
U.S. Agency	-	6,661	10,958	1,895	19,514	19,733
Corporate Bonds	603	6,779	10,878	12,032	30,292	30,092
Private Placements	-	3,135	3,803	3,334	10,272	11,806
GNMAs	-	13	54	4	71	62
CMOs	-	-	122	585	707	687
Money Market Funds	3,608	-	-	-	3,608	3,608
Total Domestic Fixed Maturity	<u>\$ 20,707</u>	<u>\$ 16,588</u>	<u>\$ 33,067</u>	<u>\$ 17,850</u>	88,212	89,801
Domestic Equities					153,064	86,494
Real Estate					<u>2,494</u>	<u>892</u>
Total Investments					\$ 243,770	\$ 177,187

The following tables provide information as of September 30, 2006, concerning credit risk:

**RATINGS OF FIXED MATURITIES
TRS**

Moody's Ratings§ (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
Aaa	\$ 907,880	\$ 917,939	16.031
AAA (SP)	255	235	0.005
Aa1	9,933	9,868	0.175
Aa2	12,284	12,158	0.217
Aa3	116,923	112,802	2.064
A1+ (SP)	67,570	67,570	1.193
A1	131,251	129,511	2.317
A2	47,333	48,238	0.836
P-1	3,966	3,966	0.070
P-2	566,554	566,554	10.003
A (SP)	38,339	35,000	0.677
A3	185,450	179,667	3.275
Baa1	294,825	250,109	5.206
BBB+ (SP)	26,739	21,898	0.472
Baa2	336,207	325,748	5.936
BBB (SP)	33,690	29,917	0.595
Baa3	137,122	136,196	2.421
Ba1	119,471	115,108	2.109
Ba2	86,145	83,462	1.521
Ba3	5,205	4,798	0.092
B2	45,775	46,737	0.808
B3	25,723	25,526	0.454
D (SP)	3,888	3,722	0.069
US Govt Guaranteed Securities	316,320	316,189	5.585
‡ Not Rated	2,144,770	2,798,015	37.869
Totals	\$ 5,663,618	\$ 6,240,933	100.000

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

RATINGS OF FIXED MATURITIES ERS

Moody's Ratings§ (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
Aaa	\$ 382,487	\$ 386,400	14.395
Aa1	4,437	4,408	0.167
Aa2	5,596	5,539	0.211
Aa3	49,139	47,679	1.849
A1+ (SP)	48,096	48,096	1.810
A1	60,119	59,289	2.262
A2	22,102	22,527	0.832
P-1	26,596	26,596	1.001
P-2	251,120	251,120	9.450
A (SP)	16,431	15,000	0.618
A3	79,842	76,686	3.005
Baa1	150,301	126,410	5.656
BBB+ (SP)	11,779	9,647	0.443
Baa2	156,446	151,743	5.888
BBB (SP)	13,234	11,606	0.498
Baa3	62,706	62,198	2.360
Ba1	57,203	55,047	2.153
Ba2	41,119	39,935	1.547
Ba3	2,082	1,919	0.078
B2	19,693	20,088	0.741
B3	11,185	11,143	0.421
Caa	99	100	0.004
D (SP)	1,944	1,861	0.073
US Govt Guaranteed Securities	144,642	144,739	5.443
‡ Not Rated	1,038,862	1,365,286	39.095
Totals	\$ 2,657,260	\$ 2,945,062	100.000

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

RATINGS OF FIXED MATURITIES

JRF

Moody's Ratings§ (Unless Noted)	Fair Value	Cost	Fair Value as a Percent of Total Fixed Maturity Fair Value
Aaa	\$ 21,390	\$ 21,610	24.248
Aa1	221	220	0.251
Aa2	263	261	0.298
Aa3	2,316	2,244	2.626
A1+ (SP)	3,608	3,608	4.090
A1	2,042	2,059	2.315
A2	1,679	1,618	1.903
P-1	999	999	1.133
P-2	15,497	15,497	17.568
A3	5,321	5,270	6.032
Baa1	5,562	5,345	6.305
Baa2	3,628	3,717	4.113
BBB (SP)	990	1,000	1.122
Baa3	4,370	4,434	4.954
Ba1	4,074	3,810	4.618
B1	1,594	1,410	1.807
B2	516	540	0.585
Caa	1,505	1,524	1.706
D (SP)	324	310	0.367
US Govt Guaranteed Securities	7,323	7,379	8.302
‡ Not Rated	4,990	6,946	5.657
Totals	<u>\$ 88,212</u>	<u>\$ 89,801</u>	<u>100.000</u>

§ The Moody's ratings are used when available. The Standard & Poor's rating is used when it is available and a Moody's rating is not available. Standards and Poor's ratings are denoted by (SP). Fixed maturity investments that are not rated are included in the "Not Rated Category".

(Dollar Amounts in Thousands)

B. Concentration of Investments

As of September 30, 2006, the TRS and ERS owned debt and equity securities of Raycom Media Corporation which represented approximately 7.7% and 8.2%, respectively, of the TRS and ERS investments.

C. Securities Lending Program

The TRS, ERS, and JRF are authorized by the Boards of Control to participate in a securities lending program. The Systems' custodian, State Street Bank and Trust Company, administers the program. Certain securities from the TRS, ERS, and JRF are loaned to borrowers approved by the Systems. Approved borrowers of securities provide acceptable collateral in the form of cash, securities issued or guaranteed by the United States government or its agencies or instrumentalities, sovereign debt, Canadian Provincial debt, convertible bonds, irrevocable bank letters of credit by a person other than the borrower or an affiliate of the borrower if State Street determines to be appropriate, and such other collateral as the parties may agree to in writing from time to time. All security loans are open loans and can be terminated on demand by the TRS, ERS, JRF, or borrower. The initial collateral received shall have (i) in the case of loaned securities denominated in United States Dollars or whose primary trading market is located in the United States, sovereign debt issued by foreign governments (other than Canada) or corporate bonds that are not denominated in United States Dollars (other than those issued in Canada), a value of 102% of the fair value of the loaned securities, or (ii) in the case of loaned securities which are not denominated in United States Dollars or whose primary trading market is not located in the United States (and are not referenced in (i)), a value of 105% of the fair value of the loaned securities, or (iii) in the case of loaned securities comprised of UK gilts, a value of 102.5% of the fair value of the loaned securities, or (iv) in all other cases, such value, not less than 102% of the fair value of the loaned securities, as may be applicable in the jurisdiction in which such loaned securities are customarily traded. Pursuant to the terms of the applicable securities loan agreement, State Street

shall, in accordance with State Street's reasonable and customary practices, mark loaned securities and collateral to their fair value each business day based upon the fair value of the collateral and the loaned securities at the close of the business employing the most recently available pricing information and receive and deliver collateral in order to maintain the value of the collateral at no less than 100% of the fair value of the loaned securities.

The TRS, ERS, and JRF cannot pledge or sell collateral securities received unless the borrower defaults. Cash collateral is invested in the State Street Quality D Short-term Investments Fund (QDF).

The following describes the QDF's fund guidelines. The QDF's average effective duration is restricted to 120 days or less. The maximum option-adjusted duration of any variable rate security investment of the QDF shall be five years or less. All fixed rate instruments must have an option-adjusted duration not to exceed 30 months. At the time of purchase, all securities with maturities of 13 months or less must qualify as first tier securities and all securities with maturities in excess of 13 months will be rated A or better by at least two nationally recognized statistical rating organizations (NRSROs), or, if not rated, be of comparable quality. The QDF may invest in other State Street managed investment vehicles provided they conform to QDF guidelines.

As of September 30, 2006, the average term of the loans was 43, 42, and 147 days, respectively for the TRS, ERS, and JRF. Cash collateral investments in the QDF are matured as needed to fulfill loan obligations. There is no direct matching of the maturities of the loans with the investments made with cash collateral.

At September 30, 2006, the fair value of the securities on loan was \$1,999,806, \$871,682, and \$24,753 for the TRS, ERS, and JRF, respectively. The fair value of the collateral pledged by the borrowers was \$2,071,863, \$903,395, and \$25,393 for the TRS, ERS, and JRF, respectively. Since the amounts owed by the TRS, ERS, and JRF exceeded

the amounts the borrowers owed to the TRS, ERS, and JRF, there was no credit risk exposure as of September 30, 2006. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Investments purchased with cash collateral are held by the custodial agent, but not in the name of the Systems. Securities pledged as collateral are held by the custodial agent, but not in the name of the Systems. Letters of credit pledged as collateral are issued by the borrower's bank and are irrevocable. The following table provides information as of September 30, 2006, concerning securities lent:

SECURITIES LENDING - INVESTMENTS LENT AND COLLATERAL RECEIVED

(at Fair Value)

Type of Investment Lent	TRS	ERS	JRF	Totals
<i>For Cash Collateral</i>				
Domestic Fixed Maturities	\$ 561,312	\$ 228,818	\$ 12,688	\$ 802,818
Domestic Equity	724,667	353,507	12,065	1,090,239
International Equity	571,455	252,350	-	823,805
Total Lent for Cash Collateral	1,857,434	834,675	24,753	2,716,862
<i>For Non-cash Collateral</i>				
International Equity	142,372	37,007	-	179,379
Total Lent for Non-cash Collateral	142,372	37,007	-	179,379
Total Securities Lent	\$ 1,999,806	\$ 871,682	\$ 24,753	\$ 2,896,241
Type of Collateral Received				
<i>Cash Collateral - Invested in State Street Quality D Fund</i>	\$ 1,922,021	\$ 864,409	\$ 25,393	\$ 2,811,823
<i>Non-cash Collateral</i>				
For Lent International Equity Securities				
Letters of Credit	4,631	1,702		6,333
Pledged Securities	145,211	37,284	-	182,495
Total Non-cash Collateral	149,842	38,986	-	188,828
Total Collateral Received	\$ 2,071,863	\$ 903,395	\$ 25,393	\$ 3,000,651

D. Mortgage-backed Securities

As of September 30, 2006, the TRS, ERS, and JRF had investments in mortgaged-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obligees tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received

under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of the mortgage-backed securities.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2006

(Dollar Amounts in Thousands)

6) FUNDING STATUS AND PROGRESS

State law provides that the Boards of Control engage an actuary to prepare an annual valuation of the assets and liabilities of the various reserve funds. Under the provisions of GASB Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*, the actuary determines the "unfunded actuarial liability." The "unfunded actuarial liability" is the difference between the actuarial value of assets and the actuarial accrued liability.

Significant actuarial assumptions used and results from the most recent actuarial valuations are presented in the "Notes to the Required Supplementary Information."

7) CONTRIBUTIONS REQUIRED AND MADE

The actuary has computed, as of the date of the latest available actuarial valuations, the estimated present value of benefits payable to retired members, beneficiaries, and active members. The actuarial valuations for the TRS and ERS are prepared using the entry age method, while the JRF valuation utilizes the projected unit credit method. The present value of all expected benefits payable from each system to the present group of members and beneficiaries is calculated by adding the present value of the expected benefits payable to the active members to the present value of the expected future payments to retired members and beneficiaries.

As required by statute, the TRS, ERS, and JRF provide for employer contributions at actuarially determined rates (expressed as percentages of annual covered payroll) that accumulate sufficient assets to pay benefits when due. The employer contributions required to support the benefits of each system are determined following a level funding approach and consist of a normal contribution, an accrued liability contribution, and a portion to finance administrative costs.

For the TRS and ERS, the normal contribution is determined using the "entry age normal" method.

Under this method, a calculation is made to determine the uniform and constant percentage rate of employer contributions which, if applied to the compensation of the average new member during the entire period of the member's anticipated covered service, would be required in addition to the contributions of the member to meet the cost of all benefits payable on the member's behalf.

For the JRF, the normal contribution is determined using the "projected accrued benefit" (unit-credit) method. Under this method, the benefits of each individual included in an actuarial valuation are allocated by a consistent formula to valuation years. The actuarial gains (losses), as they occur, generally reduce (increase) the unfunded actuarial accrued liability.

The 2006 retirement contributions were made in accordance with actuarially determined contribution requirements.

8) PROPERTY AND EQUIPMENT

Plan assets used in plan operations are reported at historical cost less accumulated depreciation. Depreciation is determined on the straight-line basis using estimated useful lives of 30 years for buildings and 3 to 10 years for furniture and equipment.

Property and equipment was comprised of the following amounts as of September 30, 2006:

	<u>TRS</u>	<u>ERS</u>
Land	\$ 5,702	\$ 2,997
Building and Improvements	13,254	7,686
Furniture and Equipment	<u>2,053</u>	<u>1,321</u>
Total Property and Equipment	21,009	12,004
Less Accum Depreciation	<u>(5,134)</u>	<u>(3,379)</u>
Net Property and Equipment	<u>\$ 15,875</u>	<u>\$ 8,625</u>

9) OTHER POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 1, the TRS, ERS, and JRF (as agencies of the State of Alabama) participate in the State Employees' Health Insurance Plan (SEHIP).

The SEHIP provides postretirement health care benefits, in accordance with State statute, to all TRS, ERS, and JRF employees who retire with a retirement benefit payable from the TRS, ERS, or JRF. The SEHIP provides a fixed amount equal to the Medicare eligible premium (presently one hundred ten dollars per month) for each retiree. Those retirees who are not Medicare eligible must pay the difference to maintain the insurance. Under the SEHIP statute, the fixed amount per month per retiree is funded on a pay-as-you-go basis through the premiums each agency pays for its active employees. During the fiscal year 2006, the estimated portion of health insurance premiums paid and included in administrative expense by the TRS, ERS, and JRF on behalf of retirees was \$91, \$89, and \$1, respectively.

10) PENSION PLAN FOR RSA EMPLOYEES

A portion of the RSA employees participates in the TRS pension plan, which is a cost sharing plan, and a portion of the RSA employees participates in the ERS pension plan, which is an agent multiple-employer pension plan. As a component unit, RSA employees participating in the ERS pension plan are valued with all other State of Alabama employees, and therefore, report under the requirements of a cost sharing unit.

Contributions were made to each plan in accordance with actuarially determined contribution requirements. A schedule of Employer Contributions is shown below:

	Fiscal Year	Annual	Percentage
	Ended	Required	Contributed
		Contributions	
TRS	2006	\$ 613	100
	2005	469	100
	2004	418	100
ERS	2006	422	100
	2005	291	100
	2004	216	100

11) TREND INFORMATION

The schedules of funding progress and employer contributions, as required by GASB Statement No. 25, are presented in the Required Supplementary Information section.

12) RELATED PARTY TRANSACTIONS

The TRS and ERS jointly own office buildings in Montgomery and lease office space to agencies of the State of Alabama. These agencies are obligated to the TRS and ERS to lease space for varying terms through the year 2019. Rental payments (reported as investment income) from leases with state agencies totaled \$20,843 during the 2006 fiscal year.

(Dollar Amounts in Thousands)

1) CONTRIBUTIONS

Contributions were made in accordance with actuarially determined contribution requirements. The employer cost rate expressed as a percent of payroll is determined annually by reviewing a variety of factors including benefits promised, member contributions, investment earnings, mortality, and withdrawal experience.

The employer cost rates for the fiscal year 2006-2007 are 9.36% for the TRS, 7.78% for the ERS - State Employees, 24.12% for the ERS - State Police and 22.50% for the JRF. Local agency rates differ for each agency.

2) ANALYSIS OF FUNDING PROGRESS

Analysis of the dollar amounts of the actuarial value of assets, the actuarial accrued liability, and the unfunded actuarial accrued liability in isolation may be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability (assets to liabilities percentage) provides one indication of the respective retirement system's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the respective system is becoming financially stronger or weaker. Generally, the strength of a retirement system is considered to increase as the assets to liabilities percentage increases. Trends in the actuarial accrued liability and the annual covered payroll are affected by inflation. Expressing the unfunded accrued liability as a percentage of annual covered payroll (liabilities to payroll percentage) approximately adjusts for the effects of inflation and aids analysis of the respective retirement system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the strength of a retirement system is considered to increase as the liabilities to payroll percentage decreases.

The following schedules provide information concerning funding progress, employer contributions, and actuarial assumptions:

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded/ (Overfunded) AAL (UAAL)	Percentage Funded (A/B)	Annual Covered Payroll (C)	UAAL as a % of Covered Payroll ((B-A)/C)
	(A)	(B)	(B-A)	(A/B)	(C)	((B-A)/C)
TRS						
9/30/2005	\$19,248,207	\$ 23,027,338	\$ 3,779,131	83.6	\$5,326,408	71.0
9/30/2004	18,704,009	20,886,190	2,182,181	89.6	4,846,677	45.0
6/30/2003	18,110,470	19,357,735	1,247,265	93.6	4,632,611	26.9
6/30/2002	17,904,881	18,374,174	469,293	97.4	4,379,183	10.7
6/30/2001	17,475,298	17,238,616	(236,682)	101.4	4,305,080	(5.5)
6/30/2000	16,703,929	16,291,462	(412,467)	102.5	4,131,904	(10.0)
ERS						
9/30/2005	8,935,358	10,634,976	1,699,618	84.0	2,982,122	57.0
9/30/2004	8,563,945	9,546,478	982,533	89.7	2,702,393	36.4
9/30/2003	8,312,500	9,124,279	811,779	91.1	2,677,025	30.3
9/30/2002	8,100,846	8,493,469	392,623	95.4	2,547,775	15.4
9/30/2001	8,028,471	8,010,123	(18,348)	100.2	2,408,543	(0.8)
9/30/2000	7,769,122	7,403,968	(365,154)	104.9	2,278,637	(16.0)
JRF						
9/30/2005	256,091	299,664	43,573	85.5	40,144	108.5
9/30/2004	251,844	293,055	41,211	85.9	39,419	104.5
9/30/2003	247,011	285,123	38,112	86.6	39,742	95.9
9/30/2002	245,425	289,858	44,433	84.7	39,763	111.7
9/30/2001	245,705	289,044	43,339	85.0	38,694	112.0
9/30/2000	239,023	268,598	29,575	89.0	40,325	73.3

See Notes to the Required Supplementary Information .

RETIREMENT SYSTEMS OF ALABAMA*Financial Section***Required Supplementary Information****For the Fiscal Year Ended September 30, 2006**

(Dollar Amounts in Thousands)

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended	Annual Required Contribution	Percentage Contributed
TRS		
9/30/2006	\$ 434,195	100
9/30/2005	347,862	100
9/30/2004	312,474	100
9/30/2003	235,786	100
9/30/2002	265,670	100
9/30/2001	279,880	100
ERS		
9/30/2006	241,750	100
9/30/2005	195,846	100
9/30/2004	170,713	100
9/30/2003	154,218	100
9/30/2002	123,887	100
9/30/2001	122,483	100
JRF		
9/30/2006	8,916	100
9/30/2005	8,943	100
9/30/2004	8,994	100
9/30/2003	8,637	100
9/30/2002	8,222	100
9/30/2001	7,598	100

See Notes to the Required Supplementary Information .

RETIREMENT SYSTEMS OF ALABAMA

*Financial Section***Notes to Required Supplementary Information****For the Fiscal Year Ended September 30, 2006**

ACTUARIAL ASSUMPTIONS

	TRS	ERS	JRF
Valuation date	September 30, 2005	September 30, 2005	September 30, 2005
Actuarial cost method	Entry age	Entry age	Projected unit credit
Asset valuation method	5-year market related value	5-year smoothed market	5-year smoothed market
Amortization method	Level percent open	Level percent open	Level percent open
Remaining amortization period	20 years	Within 20 years - varies by employer	20 years
Actuarial assumptions:			
Investment rate of return ‡	8%	8%	8%
Future salary increases ‡	5.00%-7.75%	4.61%-7.75%	5%
Cost of living increases	None	None	None

‡ Includes inflation at 4.5%.

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Administrative Expenses

For the Fiscal Year Ended September 30, 2006

(Amounts in Thousands)

	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Personal Services:				
Salaries	\$ 4,766	\$ 4,074	\$ 342	\$ 9,182
Employee Fringe Benefits	1,248	1,148	54	2,450
Total Personal Services	<u>6,014</u>	<u>5,222</u>	<u>396</u>	<u>11,632</u>
Professional Services:				
Actuarial	80	165	20	265
Accounting and Auditing	40	36	16	92
Information Technology	2,607	763	-	3,370
Education & Training	16	16	-	32
Information & Research	3	2	-	5
Mailing Services	169	111	-	280
Legal Services	-	24	-	24
Personnel Services	38	-	-	38
Other Professional Services and Fees	18	17	-	35
Total Professional Services	<u>2,971</u>	<u>1,134</u>	<u>36</u>	<u>4,141</u>
Communications and Travel:				
Telephone	72	57	-	129
Telecommunication Lines	41	32	-	73
Internet Access	23	11	-	34
Postage	747	574	-	1,321
Travel	96	76	-	172
Total Communications and Travel	<u>979</u>	<u>750</u>	<u>-</u>	<u>1,729</u>
Rentals:				
Office Space	463	309	-	772
Equipment Leasing	55	6	-	61
Total Rentals	<u>518</u>	<u>315</u>	<u>-</u>	<u>833</u>
Miscellaneous:				
Supplies	776	384	-	1,160
Maintenance	67	45	-	112
Total Miscellaneous	<u>843</u>	<u>429</u>	<u>-</u>	<u>1,272</u>
Total Administrative Expenses	<u>\$ 11,325</u>	<u>\$ 7,850</u>	<u>\$ 432</u>	<u>\$ 19,607</u>

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Investment Expenses

For the Fiscal Year Ended September 30, 2006

(Amounts in Thousands)

	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Investment Activity				
Investment Management Fees:				
Salaries and Benefits	\$ 4,222	\$ 2,687	\$ -	\$ 6,909
Dues and Subscriptions	326	303	-	629
Travel	35	4	-	39
Professional Services:				
Investment Advisor	60	30	-	90
Investment Custodian	134	85	2	221
Investment Information	10	5	-	15
Real Estate Appraisal	160	102	-	262
Total Investment Activity Expenses	4,947	3,216	2	8,165
Securities Lending Activity				
Securities Lending Borrower Rebates	77,407	32,567	861	110,835
Securities Lending Management Fees	1,271	504	7	1,782
Total Securities Lending Activity Expenses	78,678	33,071	868	112,617
Total Investment Expenses	\$ 83,625	\$ 36,287	\$ 870	\$ 120,782

RETIREMENT SYSTEMS OF ALABAMA

Financial Section

Schedule of Professional/Consultant Fees

For the Fiscal Year Ended September 30, 2006

(Amounts in Thousands)

Professional/Consultant	Nature of Service	Teachers' Retirement System	Employees' Retirement System	Judicial Retirement Fund	Totals
Cavanaugh MacDonald	Actuary	\$ 80	\$ 165	\$ 20	\$ 265
KPMG	Auditor	40	36	16	92
Crum Defense Escrow Account	Legal	-	24	-	24
Avanade, Inc.	Information Technology	2,465	667	-	3,132
Covenant Technology Solutions	Information Technology	96	96	-	192
Auburn University Montgomery	Information Technology	39	-	-	39
Postini, Inc.	Information Technology	4	-	-	4
Department of Public Health	Information & Research	2	1	-	3
National Council on TRS	Education & Training	2	-	-	2
NASRA	Education & Training	-	6	-	6
NASIO	Education & Training	2	-	-	2
NCPERS	Education & Training	-	5	-	5
Microsoft Events	Education & Training	4	-	-	4
Sungard Treasury Systems	Education & Training	3	3	-	6
Timberline Users Group, Inc.	Education & Training	2	-	-	2
Action in Mailing Inc.	Mail	75	77	-	152
Finance Mail & Supply	Mail	10	17	-	27
VR Election Services	Mail	84	17	-	101
State Personnel Department	Personnel	38	-	-	38
Various	Other	25	20	-	45
Total Professional/Consultant Fees-Admin Services		2,971	1,134	36	4,141
AmSouth Bank	Investment Advisor	60	30	-	90
State Street Bank & Trust Co.	Investment Custodial	134	85	2	221
ADP Investor Communications Svcs	Investment Information	10	5	-	15
Houlihan, Lokey, Zukin Fin. Advisors	Real Estate Appraisor	160	102	-	262
Total Professional/Consultant Fees-Investment Services		364	222	2	588
Total Professional/Consultant Fees		\$ 3,335	\$ 1,356	\$ 38	\$ 4,729